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UNCLAS BOGOTA 011571

SIPDIS

SENSITIVE

E.O. 12958: N/A

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SUBJECT: COLOMBIA WOULD BE FURTHER IN THE RED IF NOT FOR WINDFALL PROFITS FROM THE STATE OIL COMPANY

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¶11. (SBU) Summary. With oil trading at around USD 50 a barrel, Ecopetrol's windfall profits continue to rise. GOC officials have stated privately that were it not for the record revenues of the state oil company, the GOC would not make its 2004 deficit target of 2.5 percent of GDP. End Summary.

Increase in oil prices

¶12. (U) Betting conservatively, the GOC estimated that for 2004 oil would sell at an average price of USD 25.1 per barrel due to the reincorporation of Iraq's oil into the world market and its predictions of increased oil production from Algeria, Libya, Nigeria and the UAE. The GOC thus estimated that Ecopetrol, the state oil company, would transfer USD 333 million to government coffers. As oil prices rose, Ecopetrol recalculated its oil's reference price at USD 35 per barrel, netting a profit of USD 590 million as of June 2004. With oil trading in the USD 45-50 range, Ecopetrol will likely recalculate the reference price once more before the year is over. As a result, Ecopetrol's president, Isaac Yanovich, stated 2004 annual net profits could reach USD 770 million (a 39 percent increase from 2003), depending on the WTI price of oil.

A Sigh of Relief from the Ministry of Finance

¶13. (U) The Finance Ministry hoped to achieve its IMF-mandated 2.5 percent of GDP fiscal deficit target through serious belt-tightening and a series of privatizations. The GOC also obtained the IMF's agreement to a 2.8 percent fiscal deficit target for 2004, in case its privatization program did not materialize. The GOC managed to sell only 8 percent of ISA, the state-owned electric and transmission grid, and Transelca, another state-owned power distributor. Its first attempt to sell the state-owned Coffee bank (Bancafe) failed when no bidders expressed interest. The GOC was thus faced with severe spending cuts in order to meet the deficit target. Luckily, Ecopetrol's windfall profits will allow the GOC to meet its initial target without needing such severe measures.

Windfall Profits

¶14. (SBU) Econoffs met with Dr. Javier Rondon, Deputy Director for National Finances, at the Ministry of Finance and Public Credit to discuss the current fiscal deficit. Rondon, as well as Dr. Juan Pablo Zarate, the Director for Macroeconomic Policy, stated categorically that without Ecopetrol's increase in revenues, primarily due to the increase in the price of oil, the GOC would not have met its 2.5 percent deficit goal. The GOC's 2004 financial plan initially estimated that Ecopetrol would contribute 0.3 percent of GDP towards the fiscal deficit, but after revising Ecopetrol's numbers with the high price of oil, the GOC now estimates Ecopetrol's contribution at 0.6 percent of GDP.

Looking Forward

¶15. (SBU) Colombia's oil production dropped 2.5 percent in 2004, while Ecopetrol (and the GOC's coffers) were saved by the dramatic increase in oil prices in 2004. Efforts to correct the current fiscal situation, through tax and pension reform, are before Congress but have only begun their lengthy and treacherous course. The GOC is championing an expansion of the value added tax (which currently only covers about 60 percent of products), but Congress is not supporting the effort. The GOC is also attempting pension reform, which is again very unpopular with the Congress. Business groups are also protesting the GOC's annual tax reforms (three in three years) as being bad for the investment climate. Despite a spate of new oil exploration contracts, Colombia's crude

production could drop to the point where the country will
become a net importer in 2008.

DRUCKER